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TICKED OFF by Paulette Miniter (Author Archiver

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Redemptions Force More Funds to Liquidate

IN MORE PROOF that bad markets can be self-fulfilling, the number of mutual funds that are liquidating is on the rise.

Some 345 share classes of stock mutual funds have liquidated this year, through Nov. 1, according to Lipper. That's up 69% from the same period last year and a little more than double from 2006.

A snowball effect is partly to blame. Stocks are falling not just because investors are pricing in a recession, but also because institutional investors are being forced to sell in order to meet margin calls. In turn, worried mom-and-pop investors are pulling their money out of mutual funds, which is forcing fund managers to sell stocks to raise cash, hurting performance and risking losing more shareholders.

We're already seeing layoffs in the mutual-fund

industry as a result. Fidelity, which hasn't liquidated any funds this year, has said it'll lay off 1,300 employees, or 3% of its work force, this month. A second round of job cuts is expected next year. American Century has cut 270 jobs, or 17% of its work force. Morningstar's Kasse Russekewicz has said cutbacks could become "an alarming industrywide problem as redemptions reach an all-time high and fund companies are forced to scale back their resources."

Big disruptions aren't something fund investors should want since the cost is ultimately borne by the shareholders who don't flee and instead try to tough out the volatility. This is because, as Morningstar's Karen Dolan has explained, if a fund manager has to sell stocks at lower prices to meet redemptions, then paper losses become real ones and trading costs start racking up.

If there's a bright side it's that some amount of redemptions is manageable in the short run. There's a company called Reflow, which started in 2003, that some mutual-fund shops use. It acts as a temporary shareholder for funds experiencing redemptions so managers aren't forced to sell stocks immediately to raise cash. "We're seeing a lot of demand in the fixed-income area where there's been days of intense disruptions," says Reflow President Paul Schaeffer. "This year has been our biggest for growth, and the second half of the year has been our fastest-growing period."

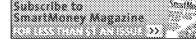
Schaeffer says by the end of 2008 Reflow should have 30 clients. Some current ones include Oppenheimer. If your mutual fund uses Reflow, it may be some consolation that it's employing a novel technique to better manage a fund performance. Aside from that, "there's really not too many things a manager can do," says Morningstar analyst Andrew Gogerty. Managers can opt to keep more cash on hand rather than putting it to work in the market, but then again cash on the sidelines is already contributing to illiquidity in the market. Managers can also tighten up their portfolios to focus on their highest-conviction investments and strategically sell stocks to offset any capital gains and lower year-end tax

Also, some liquidations are deserved. The market is now doing the tough work of clearing itself. Allianz Global Investors, for instance, isn't weeping over the death of Allianz OCC Small Cap Value Fund, which liquidated Sept. 30 after about a year of poor performance that didn't meet internal expectations.

"Over the last 10 years there's been a huge proliferation of mutual funds and these kinds of environments cause some kind of discipline to be instilled in the market," says Horacio Valeiras, chief investment officer for Oppenheimer Capital, a unit of Allianz that manages funds. "It's a cleansing-out that needs to take place."

Cash Flow Leaders & Laggards:

Top 10 funds by net inflows



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Index	Price	Chg	% Ohg.
DJIA	11118.49 🕹	4.54	0.04%
Masdag	2507.41 🔉	0.04	0.00%
36P 500	1183.26 ¥	0.52	-0.04%
Flucsell 2000**	703.35 à	2.32	0.33%
10 Vr Bond	2.60 🔻	-0.06	-9.26%
DJ Total Market Index	12412.30 🛦	8.65	0.97%
S&P 400	829.13 &	2:22	0.27%
Nasdag 100	2124.45 🕏	-5.28	-0.25%
DJ Transportation	4754.29 🛦	20.11	0.42%



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Fund Name	Ticker	Cash Flow YTO 3*
		(in billions)
Vanguard Total Stock Market	XMSTV	12.15
American Funds Fundamental Invs A	ANCEX	5.73
Eaton Vance Large-Cap Value A	EHSTX	4.81
American Funds Growth	AGYHX	4.68
Vanguard Institutional Index	AINIX	3.93
CGM Focus	OGMEX	3.65
Fairholme	FAIRK	3.29
Hartford Capital Appreciation A	THAX	2.92
Van Kampen Capital Growth A	ACPAX	2.83
GMO U.S. Quality Equity III	GGHYX	2.64

Top 10 funds by net outflows

Fund Name	Noker	Cash Flow Y1D \$1
		(in billions)
American Funds Washington Mutual A	AWSHX	-5.15
American Funds Invmt Co	AWSX	-4.20
Legg Mason Value Prim	UMYTX	-3.43
Van Kampen Comstock A	ACSTX	-3.01
Fidelity Growth & Income	FORIX	-2.75
Vanguard Windsor II	YWNFX	-2.35
Fidelity Magellan	FMAGX	-2.34
Fidelity Dividend Growth	FOGEX	-2.25
Putnam Fund for Growth & Income A	PGBWX	-2.09
Lord Abbett Mid-Cap Value A	EAVEX	-2.02
* Through 9/30/08		
Source: Morningstar		

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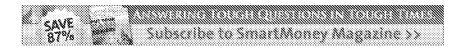
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